$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

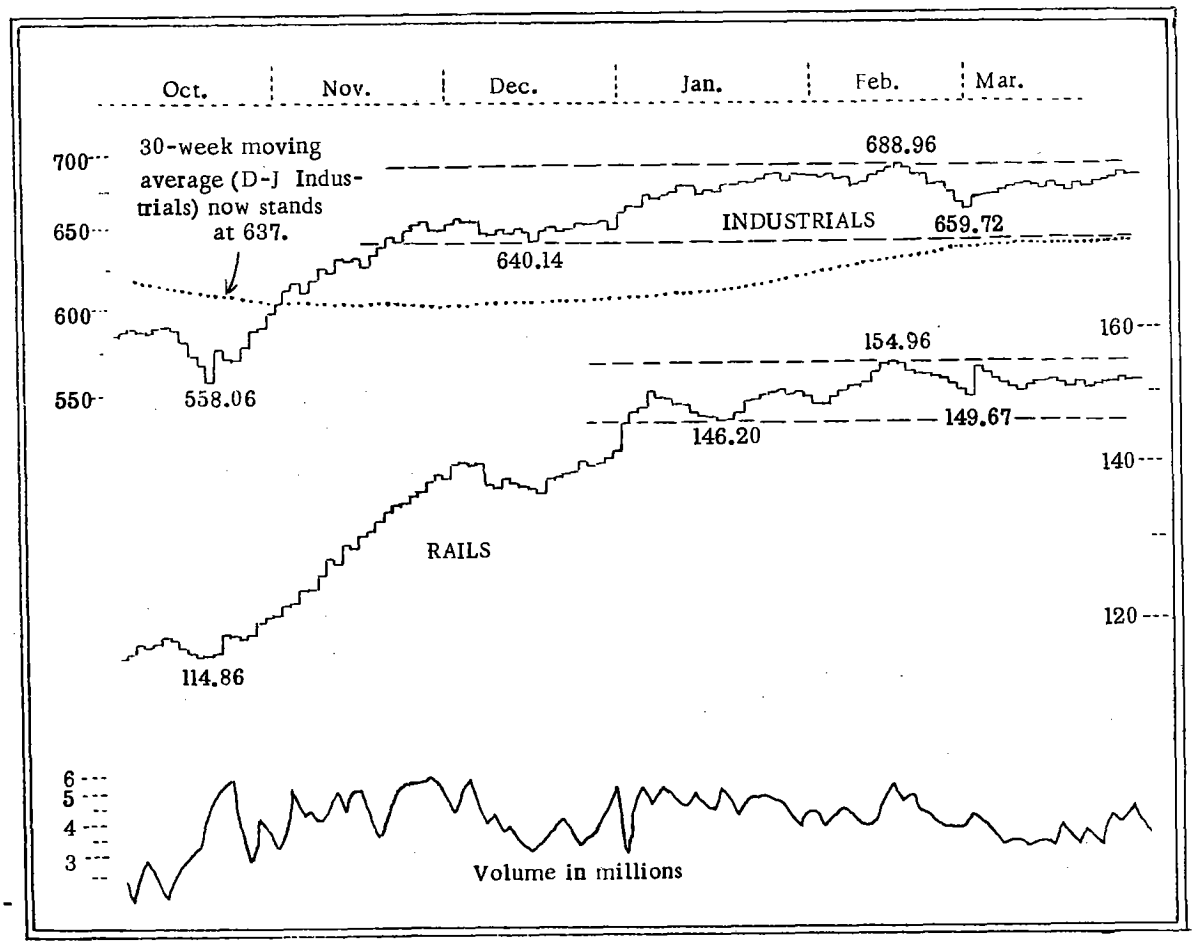
Registered with the Securities and Exchange Commission

THE MARKET The long "line" which was described in Letter 213 continues. As of this writing, Industrials are within striking distance of the upper limits (688.96) of the line and Rails are within 2 points of the upper limits (154.96) of their own line. If both Averages can break above the line limits on increasing volume, it will be a forecast of higher prices and improving economic conditions. Conversely, the bearish implications of a joint penetration of the lower line limits should be patently obvious.

The 30-week moving average (see chart) of the D-J Industrials has "flattened out", and this is indicative of a market which has lost its (in this case upward) momentum. Perhaps coincidentally, the 30-week moving average roughly corresponds to the lower limit of the Industrial line.

Predictions as to which way the market will eventually "break out" are plentiful these days, with each soothsayer using his own bullish or bearish ammunition. The business news continues rather good, but in the background stands the cloud of a deteriorating balance of payments picture, continuing unemployment, and an Administration which has its heart in the "magic-deficit" days of the Roosevelt era, its mind on the 1964 election and its body in the debt-ridden, high spending, strangely incongruous prosperity of 1963.

RAILS To this writer, one of the most fascinating items of 1963 has been the action of the Rails. Most subscribers have probably forgotten the study of D-J Rail volume which I included in Letter 207. That study showed that since 1959, whenever abnormal Rail volume appeared, it was a fair bet that distribution in the carriers was taking place.



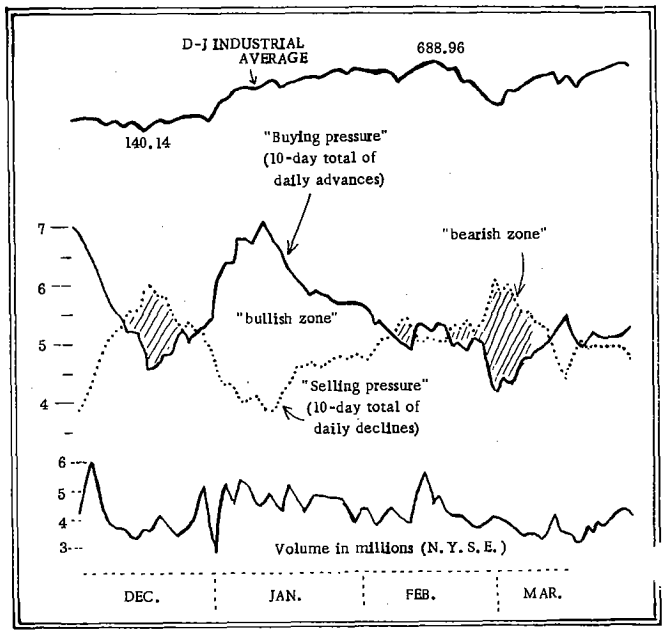
Letter 207 drew particular attention to the heavy Rail volume during January, 1963. On January 8 the carrier Average rose to 150.52 on high volume of 155 thousand shares. A day later Rail volume rose to 178 thousand shares, the heaviest Rail volume since October, 1961.

I concluded the Rail volume section of Letter 207 (January 21) with the following: "For over two years, whenever the Rail Average has entered the 148-152 range, volume has exploded in the carrier Average -- followed by a general

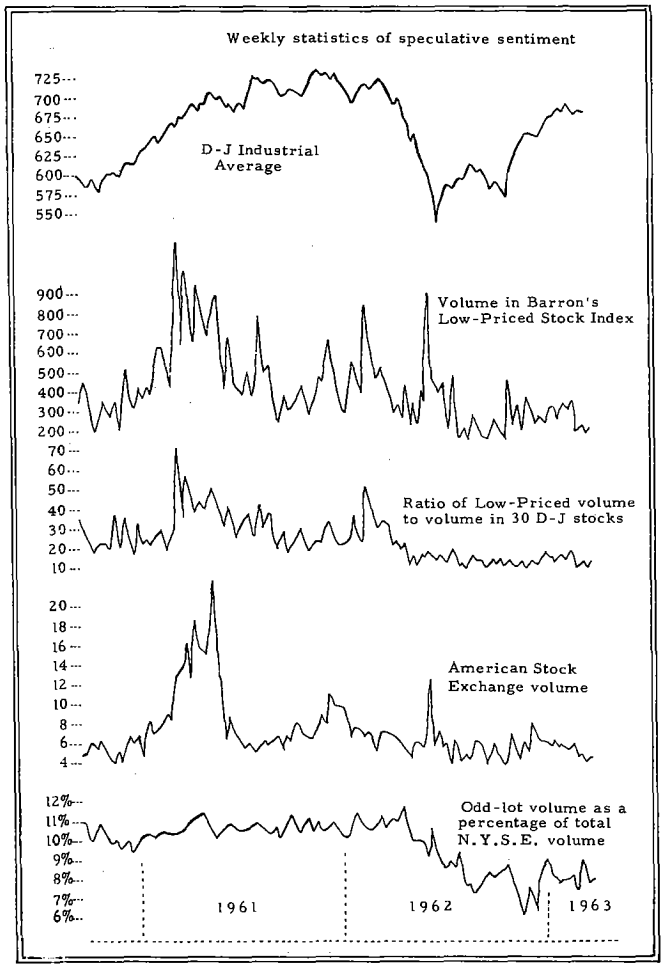
Rail decline and either a sideways movement (as per 1961) or a decline (as per 1962) in the general market. It will be interesting to see whether Rails will be able, at this time, to extend their gains above the formidable 152.92 barrier (the 1962 peak) or whether the huge Rail volume of the past few months implies that the carriers have been under distribution again."

What has occurred since Letter 207 is most interesting. On February 15, Rails rose to 154.96, their highest level in three years. This new high was widely proclaimed on Wall Street, but few noticed that a day later Rail Volume climbed to 217 thousand shares, the highest volume since March, 1961. Following that, Rails declined for nine consecutive days, then jumped over four points (but not above their 154.96 peak) on news of the Supreme Court "featherbedding" decision (March 4). As of this writing, Rails still have not bettered their peak of 154.96. The ability or inability of the carriers to "move out" above the 154.96 peak will tell us a good deal about the coming market picture.

BUYING AND SELLING PRESSURE The latest reading on the graph shows buying pressure again above selling pressure following the fifth crossing of the lines since mid-February. Volume has expanded rather noticeably since the mid-March rise of buying pressure to the dominant position. A potential major upward move will be indicated if the buying line can now move out to the 6.5 to 7 thousand advance area. Conversely, a recrossing with the selling line again assuming the dominant position would mean more stalling or the beginning of a decline of indeterminate proportions. As seen on the graph, the picture since the end of January has been one of indecision, with the forces of supply (selling) and demand (buying) fairly evenly matched.



SPECULATION So far, the 1962-63 rise has been a difficult one in which to make money. In general, two factors are necessary in order to produce profits in the stock market: (1) a fairly important percentage rise in the broad list of stocks, and (2) a fair amount of bullish speculative sentiment. The successful investor attempts to buy stocks correctly (at "low" prices), and to sell those stocks at a later date at inflated prices. But it takes the speculative public to produce inflated prices; no other element in the market will drive prices to "over-valued" levels. Therefore, it is the entrance of the public which makes for great profits in the market.


Weekly statistics of speculative sentiment
D-J Industrial Average
Volume in Barron's Low-Priced Stock Index
Ratio of Low-Priced volume to volume in 30 D-J stocks
American Stock Exchange volume
Odd-lot volume as a percentage of total N.Y.S.E. volume
1961
1962
1963

The last letter drew attention to the fact that the rise which began in October, 1962, literally terminated (in terms of percentages) in November, 1962, following which the Industrial Average began formation of a long "line". In other words, the chances of making money on the rise were slim because the rise terminated quickly and because the percentage of rise was not impressive.

The second area of difficulty focuses attention on one of the real phenomena of the 1963 market, the remarkable absence (so far) of the public. The four studies on the accompanying chart all imply that (public) speculative sentiment during the 1962-63 rise was far below that which was seen during the 1960-61 rise. Furthermore, these four studies suggest that speculative sentiment did not increase as the 1962-63 advance progressed. So far, it must be said that the public simply "isn't having any".

The first two studies (see chart) -- volume in Barron's Low-Priced Stock Index and the ratio of volume in the L-P Stock Index to volume in the Industrial Average --

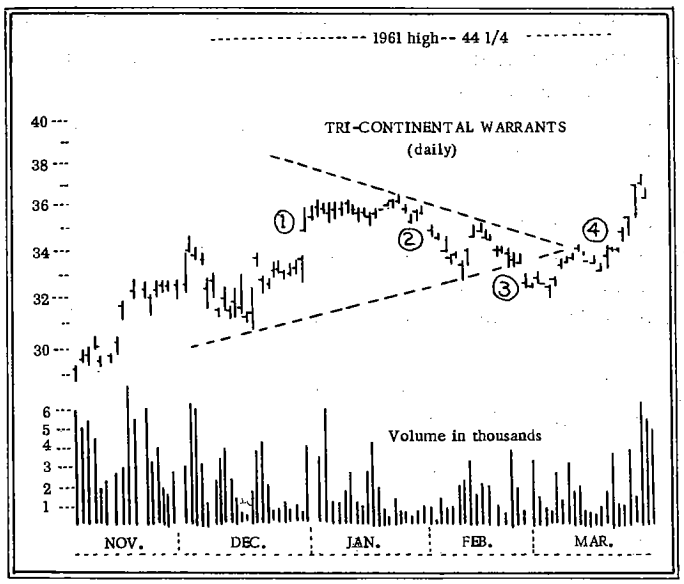
self-explanatory. As the public becomes progressively more interested in the market, they tend to move into low-priced stocks, and both of these gauges (volume and the ratio of volume) tend to rise. Suffice it to say that volume and the ratio of volume have not budged during 1962-63.

Volume on the American Exchange is another interesting barometer of speculation. As the public becomes interested in the market and in low-priced stocks (i.e. stocks which they can afford), they also become increasingly concerned with issues on the more speculative American Exchange. Interest in the American (as exemplified by volume) is currently very low.

Odd-lot trading as a percentage of total N.Y.S.E. trading is a fourth important gauge of public interest. This percentage is presently running at levels which are historically at the low end of the scale. Again, the implication is that as far as the public is concerned, Wall Street is persona non grata.

Many leading analysts are now saying that the lack of public interest is not only encouraging -- but that it is highly bullish. This is the obvious conclusion, and it is one that (in similar circumstances) has proved valid since 1949. However, I would like to remind subscribers (again) that following previous crashes the public did not return to the market. It may be different this time -- but I personally would not want to bet on it.

SEARCHING FOR "BAROMETERS" When a market becomes as difficult as this one, investors are apt to resort to "every trick in the books" in an attempt to uncover the true underlying trend. One of the "key" stocks which I always watch carefully is the Tri-Continental (TY) warrant (traded on the American Exchange). This stock is unique because it constitutes a "perpetual call" on the largest closed-end fund in the nation, Tri-Continental Corp. The warrant is perpetual (i.e., it has no expiration date), and at any time one warrant is exercisable into 1.27 shares of TY common at a price of $17.67. Since TY common now sells (on the N.Y.S.E.) for about 44, the TY warrant has an actual worth of about $33.32. The price of the TY warrant is now about 34, and this means that the market is putting a very slight premium of about 75¢ on the warrant for the privilege of conversion.



TY warrants, therefore, represent a leveraged call on the shares of a huge investment fund. The history of TY common shows that it tends to move consistently with the general market. But the warrants, being leveraged and therefore more sensitive, tend to move quicker and further than the common. If TY common advances five points, the warrant will probably rally at least five points, and obviously the percentage of rise in the warrant will be greater than in the higher-priced common.

A second leverage factor in the warrant results from the following set of circumstances: TY common almost always sells at a discount from actual assets. During a bear market this discount widens; during a bull market the discount contracts. Thus during 1950 TY common sold at a discount of 42% below actual assets, while in 1958 the common sold for only 6% below assets. This means that TY warrants possess a double leverage factor: (1) the warrants are priced below the common but they tend to move (in terms of points) with the common, and (2) the market discount on the common tends to contract during a major bull swing and widen during a bear swing, and this too is reflected in the warrant.

I might add, as a note of interest, that many professional traders like TY warrants. Because of their leverage, the warrants will usually outperform the market during a bull swing. By the same token the warrants will generally drop sharply during a weak market. A second attraction of the warrant as a short vehicle is the fact that they declare no dividend, and the short seller therefore has no "pay-out" to worry about.

I include a daily chart of the warrant covering the last four months. This sensitive stock displays rather dramatically the difficulty of the whole period. At point 1 the warrant bettered the early December peak of 34 3/4, and it seemed to be a buy. But the warrant rose to only 36 1/4 in January, then formed a "line" to the end of January. When the line was broken at point 2 the warrant appeared to be a good short sale. By mid-February a large symmetrical triangle had formed in the warrants, and when this triangle was broken (point 3) the short sales seemed "confirmed" as correct. But in early March the

down-trend was reversed, and when the warrants rose above the apex of the triangle (point 4) last week the warrants had turned "bullish". On March 27 the warrant rose above their recent peak to a new high of 37 3/8. This put them within 7 points of their 1961 peak of 44 1/4.

The breaking of the triangle at point 3 was a "false move" which was soon reversed at point 4. If the bullish trend in the warrants is the correct one, then the warrants should now either move out directly or hold in the 35-37 area on any consolidation or decline. A break below 34 would mean that the warrants had turned bearish again (and I would take such a move as unfavorable for the general market).

LATE NOTES AND COMMENTS Recent Letters have called attention to the fact that on the face of it, the market appears "technically strong". Odd-lotters continue to sell, the short interest holds above the 6 million share mark, the short interest ratio is now 1.62, and the public appears singularly disinterested in Wall Street. Yet week after week goes by, and the two Averages refuse to push out of their first quarter range.

This performance has produced an almost comic confusion among investment services (and I claim no superior vision myself). The writer "trades" services with perhaps fifteen other organizations, and my reading matter these days is nothing short of amazing. One leading service recently gave a "bear signal" but this week it cautions against too much bearishness. Another leading service gave a "bull" signal a few months ago but has been increasingly bearish. And speaking of actions that belie the facts, James Hughes of New York (in his latest report) says: "There has never been anything in our peacetime history that approximated that bank credit expansion of 1961-62... Probably the most amazing aspect of the $19 billion expansion in loans and investments during 1961-62 was that it did not prove too stimulating either to general business activity or the stock market." Technical strength has not budged the market, an historic expansion in bank credit has not produced an all-out boom. But (bullish or bearish) proof cannot be hurried. The market will tell its story when it is ready, and in the meantime, our eyes will be on the "line" as drawn on page 1 of this Letter.

As this is written (Monday, April 1, Noon, N.Y. time), the market is rallying on expanding volume in what may well be an attempt for a breakout above the upper limits of the line. It is imperative, however, that both Averages hurdle their upper line limits before bullish conclusions can be drawn. If this occurs, speculators might speculate by buying General Motors, American Smelting, Standard Oil of California, International Harvester.

STOCKS Of 350 stocks which are tabulated weekly at this office, 228 (66%) are holding above their 30-week moving average (a decline of 2% from last week). But the percentage is still well above the critical 50% level.

In studying hundreds of charts, I have noticed that a good number of stocks which have appeared "toppy" seem to be slowly moving to the upside. True, there are many exceptions such as the stocks in the weak aircraft and electronics groups, but in other groups strength is beginning to show.

For illustration I include a chart of Georgia-Pacific, a large factor in the building supply group. Note the toppy appearance of this stock during December to March, and note also the declining relative strength. But over the past few weeks GXP has suddenly moved to a new recovery high on a slight expansion in volume. If this phenomenon occurs in enough stocks (and it appears to be taking place in a good number) the long "line" will undoubtedly resolve itself to the upside. I would say that 70% of all the stocks on the "Board" are now still in sideways line formations. So far, the majority of those that have departed from their line areas have broken to the upside, and this is particularly true of the highest grade issues. The crux of the market problem is whether the lesser-grade issues will follow.

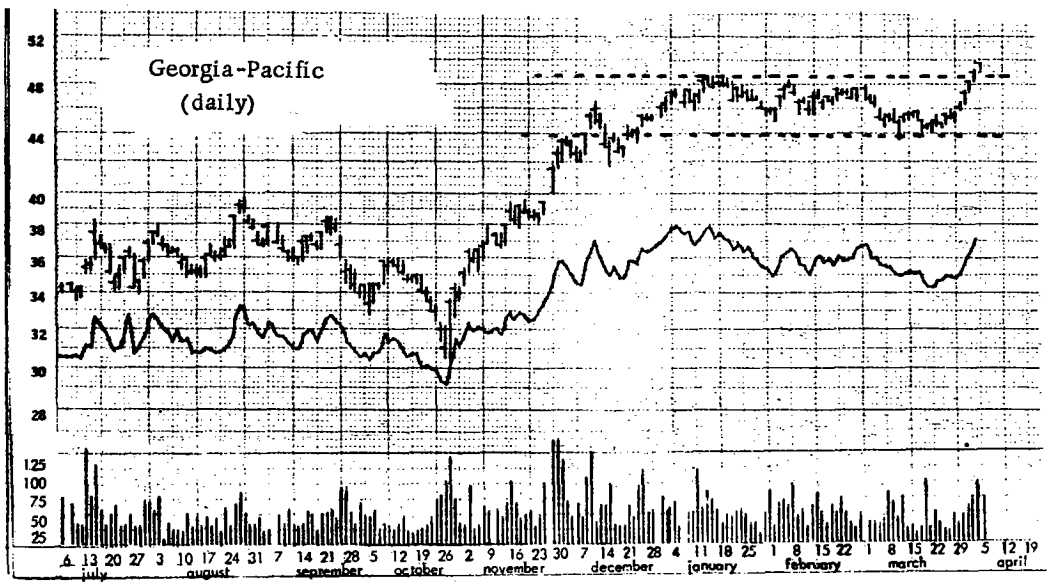


Chart of GXP courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri